May 5, 2003

The Honorable Michael K. Powell, Chairman
Federal Communications Commission
445 Twelfth Street, SW
Washington, DC 20554

Re: *Communications Daily* Report and *Financial Times* Interview and the 35% National Ownership Cap

Dear Chairman Powell:

We write in response to two press reports this past week that are inconsistent with the record in this case. (1) Record evidence shows that independently owned affiliates out perform O&Os in terms of quality of local news (awards) and are equal in terms of quantity. (2) Neither the NPRM nor the networks raise the issue of network profitability as an issue in this proceeding and the facts do not support either its relevance or validity.

Local News Quality and Quantity

The *Communications Daily* edition of Friday, May 2, reports on your statements of the previous day, as follows:

> "there was evidence [in the record] that the rule in some cases harmed the public interest. There's evidence that owned & operated stations (O&Os) produce more news and win more quality awards than independent affiliates, he [Chairman Powell] said."

The facts show the reverse to be true.

The October 1, 2002, FCC staff study (reflecting the views "of the authors alone") reached the same conclusion attributed to you by *Communications Daily* as to both quality and quantity of local news. However, NASA and NAB then showed that the conclusion was untrue when the staff study was corrected for market size. It should be obvious that this is a necessary correction: the 7,280,000 households in the New York City DMA generate more news than do the 67,000 households in the Charlottesville, Virginia, DMA. Yet the networks own 19 of the 20 network-affiliated stations in the top five markets; and in markets below the top five, their station ownership skews to the larger markets and independently owned stations skew to the smaller markets. *The networks' economist agreed that there must be a correction for market size, and in his own study he also corrected for market size. Because the FCC staff study did not do so, it must not be relied on.*

Correcting for market size and using the awards selected by the FCC staff study as a proxy for quality -- the DuPont and RTNDA awards -- independently owned affiliates outperform O&Os in terms of quality. The networks did not contest this conclusion. The networks, however, analyzed only the RTNDA awards (excluding the DuPont awards because they were more selective). Their statistics showed that independent affiliates slightly outperform O&Os, and their conclusion was that there was not a significant difference between independent affiliates and O&Os. NASA and NAB conducted the same analysis on Peabody awards, and that analysis affirmed the conclusion based on analyzing the DuPont and RTNDA awards: *independent affiliates significantly outperform O&Os in terms of local news quality (awards).*

In terms of quantity of local news, the networks' economist does not dispute that there is no significant difference between ABC, CBS and NBC O&Os and their affiliates. He claims, however, that weight should be given to the fact that the Fox O&Os outperform the Fox affiliates, despite the fact that in statistical terms, these data are outliers. But NASA and NAB then demonstrated that even this difference is *wholly* explainable by the fact that 72% of Fox O&Os are VHF stations, while only 18% of Fox affiliates are VHF stations. *The networks have been wholly silent in response. Accordingly, the record also rebuts the assertion that O&Os outperform affiliates in terms of local news quantity.*

We agree with the premise of your statement -- local news (quality and quantity) is one important indicator of stations serving the interests of localism. But the evidence in the record supports a conclusion opposite from the one reported in *Communications Daily*. The evidence in the record supports retention of the 35% cap.

<u>Network Profitability and Survival</u>

The April 30 edition of the *Financial Times*, reporting on its interview with you, contained this sentence:

> "Mr. Powell said the growth of multi-channel cable and satellite television services, which now reach more than three-quarters of US households, had placed a question mark over the willingness of television networks to continue broadcasting free of charge."

The article goes on to point out that not even the networks have "claimed financial distress." When the networks have raised issues related to network profitability, it has been in the context of the varying economic incentive of preemptions. See Letter from John C. Quale to Marlene Dortch (Apr. 21, 2003). Because this issue has not previously been raised in the rulemaking proceeding, we wish to comment on it.

First, the financial survival or health of the free broadcast networks is not among the issues raised in the notice of proposed rulemaking. Apparently, the drafters of the notice believed that that issue is irrelevant to whether the 35% national ownership cap should be retained or raised, and we agree. See Letter from Blake and Baumann to Chairman Powell and Commissioners (Apr. 23, 2003).

Second, if, however, the financial health of the networks is relevant, the record should be reopened to permit full airing of this issue (and because we think it is irrelevant we do not urge this step), for unless the issue has been advanced in oral ex parte presentations, there is little or no information before the Commission in this proceeding that bears on this issue. Accordingly, this issue should not become the ground for a decision on the 35% cap without an opportunity for the public to comment on the issue. Of course, the NASA Petition, filed on March 8, 2001, asked that this issue, among many others, be explored in a full-scale inquiry of network conditions and operations of the kind the FCC has undertaken on three previous occasions, and it contained information about network profitability at that time. But the Commission has not yet chosen to act on that Petition.

Third, the four national networks are parts of vast conglomerates whose combined 2002 revenues were nearly $200 billion. Their economic might and media reach have vastly expanded since 1996. It blinks reality to suggest (and, to our knowledge, the networks haven't) that they must be able to own television stations that directly serve 40% or 45% of the American public, instead of 35%, in order for free broadcast network operations to survive. Fox has the financial muscle to buy control of DirecTV; NBC has the wherewithal to buy a second (Spanish-language) network and station line-up; and Viacom has purchased a new cable channel from AOL/Time Warner. Moreover, many of the parent companies' other businesses, e.g., their program production operations, gather great benefits from their network business. The facts do not bespeak the networks' tottering financial position.

Fourth, the attached analysis demonstrates that the networks are financial powerhouses. To be sure, Disney's broadcast operations incurred a small loss last year, and it has the smallest O&O line-up. But ABC does not cite the cap as the cause of its loss, and by not participating in the frenzy to buy additional stations, Disney has shown that it does not believe that greater station penetration is the answer. It apparently realizes that the answer is better network programming. Moreover, the nation's local television stations that ultimately have more to lose than anyone in all of this, do not share the view that allowing the networks to own more television stations is necessary (or even related) to the survivability of the nation's free, over-the-air television broadcast system.

Fifth, oversimplified, network programming profit (or loss) is calculated by taking national network advertising revenues and subtracting programming and related costs. But that calculation fails to capture the value that the networks' parent companies achieve on the back of that network programming, which the affiliates distribute so effectively on a national (97%) basis, from (1) program production sales, (2) syndication revenues, (3) foreign sales, (4) spin-off value for their cable and Internet businesses, and (5) cross-promotion of their other businesses. Unless and until all of these financial interrelationships can be scrutinized in detail and in a public forum (a step to which the networks have never consented), the issue of network financial viability should not be used as a basis for decision in the 35% cap proceeding. *The networks have not taken a position to the contrary.*

* * *

NASA and NAB and other members of the public have responded as diligently as possible to your call for a full record. In our view, the existing voluminous record will not support, consistent with the 1996 Act or the *Fox* decision, any outcome other than retention of the 35% cap. The networks disagree. But all would agree that the decision should be made on the basis of the record. That record shows (1) that independent affiliates outperform O&Os in local news quality (awards), (2) that there is no significant difference in local news quantity, and (3) that there is no basis in the networks' financial condition to justify relaxing the rule.

Respectfully submitted,

Alan Frank
Chair
Network Affiliated Stations Alliance

Enclosure

cc: MB Docket No. 02-277 and MM Docket Nos. 01-235, 01-317, 00-244
The Honorable Kathleen Q. Abernathy, Commissioner
The Honorable Kevin Martin, Commissioner
The Honorable Michael J. Copps, Commissioner
The Honorable Jonathan S. Adelstein, Commissioner
Susan Eid, Esq.
Marsha MacBride, Esq.
Stacy Robinson, Esq.
Catherine Bohigian, Esq.
Jordan Goldstein, Esq.
Johanna Mikes, Esq.
John Rogovin, Esq.
Mr. Kenneth Ferree
Mr. Paul Gallant
Mania Baghdadi
Linda Senecal
Qualex International

MAY 5, 2003

NETWORK FINANCIAL STRENGTH

ABC: The Walt Disney Company's SEC form 10-K for the fiscal year ending September 30, 2002 reports the following information for its Broadcasting segment:

Revenues		Operating Income	
2002	$ 5,064,000,000	2002	$ (36,000,000)
2001	$ 5,945,000,000	2001	$ 783,000,000
2000	$ 6,327,000,000	2000	$ 970,000,000

CBS: Viacom's SEC form 10-K for the fiscal year ending December 31, 2002 reports the following information for its Television segment:

Revenues		Operating Income	
2002	$ 7,490,000,000	2002	$ 1,202,400,000
2001	$ 7,247,700,000	2001	$ 402,100,000
2000	$ 5,426,400,000	2000	$ 351,000,000

Fox: News Corporation's 2002 Annual Report reports the following information for its Television segment (U.S. dollars were not reported for 2001):

Revenues		Operating Income	
2002	A$ 8,160,000,000	2002	A$ 873,000,000
	US$ 4,274,000,000		US$ 458,000,000
2001	A$ 6,838,000,000	2001	A$ 1,007,000,000

NBC: General Electric's SEC form 10-K for the fiscal year ending December 31, 2002 reports the following information for NBC:

Revenues		Operating Income	
2002	$ 7,149,000,000	2002	$ 1,658,000,000
2001	$ 5,769,000,000	2001	$ 1,408,000,000
2000	$ 6,797,000,000	2000	$ 1,609,000,000
1999	$ 5,790,000,000	1999	$ 1,427,000,000
1998	$ 5,269,000,000	1998	$ 1,225,000,000

*   *   *

The big four television network companies are in robust economic health. As shown above, three of the four network companies have reported increasing revenues. "NBC reported record revenues of $7.1 billion in 2002, a 24% increase compared with 2001."[1] CBS and Fox likewise reported significantly increased revenues in 2002. The only network to report decreased

[1] General Electric, SEC Form 10-K (Fiscal Year Ended December 31, 2002).

revenues, ABC, stated that the decline was caused by "lower ratings and lower advertising rates."[2] Moreover, ABC is currently well below the existing 35% cap and could easily purchase more stations without running afoul of the cap if increased station ownership were important to increased network revenues.

In addition to rising revenues, two of the four networks reported increased operating income. "NBC reported [an] operating profit of $1.7 billion, up 18%."[3] CBS reported a very large increase in operating income, and even when adjusted to compensate for accounting changes, CBS reported a 9% increase in operating income.[4] This strong growth was achieved despite overall weakness in the economy.[5] In reporting a decline in operating income in 2002, neither ABC nor Fox identified the ownership cap as contributing to the decline or increased station ownership as a means of curing it. Disney Chairman and CEO Michael Eisner's recently announced plan to boost ABC's profitability did not include purchasing more O&O stations.[6] The Fox "decline in operating income [was] due to ratings softness at Fox Broadcasting Company, increased programming costs and a weak advertising market."[7]

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[2] Walt Disney Company, SEC Form 10-K (Fiscal Year Ended September 30, 2002).

[3] General Electric, SEC Form 10-K.

[4] Viacom, SEC Form 10-K (Fiscal Year Ended December 31, 2002).

[5] The overall economy, as measured by the real Gross Domestic Product, increased only 2.4% in 2002. Bureau of Economic Analysis, U.S. Department of Commerce, Gross Domestic Product Percent Change from Preceding Period (Apr. 25, 2003).

[6] Diane Mermigas, *Disney Plans New TV Model; Big Loss Spurs Eisner to Action*, Electronic Media, Oct. 7, 2002, at 1.

[7] News Corporation Limited, 2002 Annual Report.